Louisiana Corporate
Credit Union

March 3, 2010

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Proposed Corporate Credit Union Regulation Part 704

Dear Ms. Rupp:

On behalf of the management and Board of Directors of Louisiana Corporate Credit Union, we appreciate the opportunity to provide comments on the proposed corporate credit union Regulation, Part 704.

Louisiana Corporate has $180 million in assets, with more than 180 credit members in Louisiana and five other states, and provides credit, investment, correspondent, ALM and funds-transfer services. We are a member of U.S. Central Federal Credit Union. Proving that efficiency is not determined by mass, Louisiana Corporate has historically achieved some of the industry's lowest operating expense to member credit union ratios, and the lowest number of employees to members ratio. We have been able to do this while maintaining extremely high service ratings from our membership.

In 2002, we wrote the NCUA Board to express our opposition to the amendment of Part 704 to allow investments down to the BBB level, as we felt such investments were excessively speculative for corporate credit unions and feared they would cause losses that would damage member confidence in our industry.

While the proposed regulation contains some beneficial changes, it also contains many that would significantly limit the value corporates provide and are therefore not in the best interests of the credit union system. If these regulatory changes were implemented, they would threaten the entire credit union system by: limiting the availability of lines of credit to natural-person credit unions; increasing the cost of correspondent services; and all but shutting down the national credit union payment and settlement system – one of the most efficient, cost effective operations in credit unions' history.

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704.2 Definitions – Available to cover losses that exceed retained earnings

The regulatory mandate to permanently deplete capital based on estimated losses created by OTTI models is a major concern as it leaves corporates with no ability to replenish existing capital holders' capital if actual losses are less than projected. Reputable CPA and law firms have opined that GAAP does not require the treatment being applied by the NCUA, which is covered in the Letter to Credit Unions 09-CU-10 and now included in the proposed revised definitions. Further, as part of its Accounting for Financial Instruments project, it is likely that the Financial Accounting Standards Board will change the credit impairment model standards in 2010, to allow OTTI reversals as loss projections improve. NCUA regulatory accounting treatment should allow for the same accounting treatment as national standards rather than permanently deplete credit union capital based on projections that will continually change. Permanent depletion of equity without right of recovery, absent a judicially supervised liquidation or bankruptcy, is unprecedented in financial institutions or business.

704.3 Corporate Credit Union Capital

We recommend clarification of the 36-month timeframe for achieving the leverage ratio, as described in the recent town hall meetings. In addition to the leverage ratio, we request that the NCUA also make the effective date of Tier 1 risk-based capital ratio 36 months. The uncertainty of any corporate being able to achieve a positive gross spread under the proposed regulation – despite any degree of consolidation, along with the uncertainty regarding the final disposition of failed investments – would make it difficult to raise new capital, pending some clarity on these issues. The issuance of clean audit opinions for the NCUSIF for 2008 and 2009 would also provide credit unions with additional due-diligence information necessary to make their decisions on corporate recapitalization.

704.14. & 701.14(a)2 Representation

Limiting service on Boards of Directors to individuals who currently hold a CEO, CFO, or COO title would prevent otherwise qualified individuals from serving, and is fundamentally opposed to credit unions' history and tradition of volunteer governance. U.S. Central's former Board consisted almost exclusively of CEOs; and despite the presence of a full time, onsite NCUA examiner, it did not prevent the failure of that institution on such an epic scale that it threatens the viability of the entire credit union industry.

704.8(h) Two-year average life

The proposed regulation would limit corporates' investment maturities so severely that they would not be able to generate a positive gross margin and could not be profitable, regardless of the degree of consolidation and expense reduction. Further, it fails to contemplate core-deposit assumptions for overnight deposits on a historical basis. The NEV testing provisions contained in the current regulation adequately measure and limit this risk. A prompt and effective supervisory response when failed corporates went out of NEV regulatory compliance may have alleviated several of the issues that this provision is designed to address.

The earnings restriction is so severe that no amount of corporate consolidation would allow a corporate to reduce expenses sufficiently to allow for a positive gross margin, because it would not allow a corporate to cover its cost of funds. Instead, it would result in greater credit risk in the corporate system in an effort to meet capital-restoration requirements. This can be seen in NCUA's choice of student loan asset-backed securities to illustrate an investment that could produce sufficient income under the proposal. The particular asset-backed securities chosen by NCUA in the illustrative appendix are at a discount margin which suggest credit ratings at the "C" level and are not available in sufficient market capitalization to cover the total amount of investable funds that would be required by corporates.

This weighted-average-life limit would severely hamper a corporate's ability to invest in government-sponsored-enterprise (GSE) MBS. While we realize that the lower-rated, private-label MBS corporates were allowed to purchase at the riskier levels of NCUA's expanded-authority regulations caused the losses, GSE securities were not the problem. The continued diminishment of U.S. Central's ability to provide a reliable liquidity source, despite imposition of severe intraday balance penalties, would make it necessary for corporates to hold agency MBS as collateral for credit lines at the FHLB or other non-credit union sources with adequate liquidity reserves. The Federal Reserve's growing concerns with the health of the failed corporates would require all corporates to hold agency MBS as Federal Reserve negative intraday balance collateral.

Finally, this section would severely diminish a corporate's ability to provide credit, causing credit unions to turn to the FHLBs and forcing smaller credit unions to enter the securities markets to obtain agency securities to secure non-corporate system credit lines.

Ability to generate UE growth - illustration in the preamble

The preamble contains an example of how to generate a positive spread under the provisions of the proposed regulation. This example is severely flawed and not achievable under real-world market conditions. It does not provide for the cost of funds of new capital, which would undoubtedly reflect the risk vs. return principal in its pricing. The model assumes discount margins on student loan asset-backed securities that are clearly unreasonable, in the opinion of nearly all professionals with day-to-day knowledge of the investment markets. The assumptions on these spreads and other factors also appear to be unreasonable or unachievable. The example illustrates how the proposed regulation's focus on interest rate risk, instead of credit risk, would force corporates into higher degrees of credit risk in an attempt to generate a positive gross margin.

A fundamental flaw in the proposed regulation is that it attempts to address institutional failures caused by excessive credit risk, poor management, and ineffective supervision by restricting interest rate risk. Interest rate risk was not a significant causative factor, and focusing on it only increases the potential for credit risk. We respectfully request that NCUA review the example provided and verify it with outside sources to ensure the regulation allows for a viable corporate business model. The verification should not only cover mathematical accuracy, but also reasonableness with respect to conditions in the capital markets.

704.8(k) Deposit Concentrations

The proposed 10 percent limit is below the amount many credit unions use for settling payment-systems transactions, potentially forcing them to settle directly with the Federal Reserve or commercial banks. This would be prohibitively expensive and labor intensive for most small-to-medium sized credit unions. Further, it could place a burden on the Federal reserve banks because they would be forced to deal directly with thousands more endpoints. Alternatively, it would cause corporates to sweep excess member deposits on a daily basis to a mutual fund or other vehicle outside the oversight of federal and state credit union regulators.

Concentration limits on investment types by NPCUs are more properly addressed in Part 703. Addressing them in Part 704 effectively assigns NCUA's regulatory responsibilities to corporate credit unions. Unless the Board's objective is to encourage accelerated consolidation of NPCUs, this section of the regulation should be considered for deletion.

Non-Performing Assets

This regulation does not address the final disposition of failed investments that U.S. Central and some corporates continue to hold on their books, yet it would require new capital to be raised from each corporate's membership. Without transparency on plans for final disposition of failed investments, corporates' strategic planning and the due diligence of NPCUs on recapitalization investment decisions is hindered.

704.19 (h) – Disclosure of Executive Compensation

We support the disclosure of CEO compensation and golden-parachute arrangements, as well as compensation arrangements agreed upon as a condition of mergers. However, we oppose the disclosure of junior management compensation. Because this provision would include corporate vice presidents whose compensation is in a far lower range than the executives of publically traded banks, upon whose regulation this provision is apparently modeled, it would make it even more difficult to attract and retain talent on a competitive basis with other financial institutions. Further, as a state chartered corporate, we currently disclose this information in IRS filings.

Sections 709 & 747 & Appellate Processes

These provisions usurp state authority with respect to the liquidation and conservatorship of state-chartered corporates and may be subject to constitutional challenges. The broad, sweeping and unprecedented powers granted solely to the NCUA under this regulation are not accompanied by any clear appellate or oversight functions, whether internal or external to the agency.

Lessons Learned and Other Contributing Factors

While the proposed revised regulation attempts to address regulatory factors that may have contributed to institutional failures in the corporate system, other factors should also be studied and considered. Many red flags existed prior to the sudden institutional failures, including the fact that these corporates were operating outside NEV limits or in violation of existing regulations or audit requirements. Audit reports delayed well over a year are a clear sign of potential problems that should warrant an appropriate regulatory response.

Historically, OCCU has not been reticent about going beyond the letter of the regulation when necessary, either through citation of safety and soundness issues or references to sound business practices. There are substantial indications that prompt enforcement of existing regulations may have alleviated this tragedy. Therefore, it may not be proper to assume that these problems can be addressed solely through a regulatory modification. Due to these factors, and the epic and pervasive nature of these institutional failures, as well as the broad powers granted to NCUA in the proposed regulation, we respectfully recommend that the NCUA Board request a study of the causes and supervisory response to the systemic failures should be undertaken and supervised by an appropriate entity as may be directed by Congress, such as the Government Accountability Office (GAO) and/or the U.S. Department of the Treasury.

We also recommend that the NCUA Board institute an investigation into the circumstances concerning U.S. Central's Paid-In Capital II issuance, and its complete loss of value less than 30 days later. We encourage the Board to determine whether it received an accurate and adequate disclosure of U.S. Central's condition prior to its granting the regulatory waiver. This waiver effectively made the purchase of PIC II mandatory for corporates that felt compelled to prevent the disruptions to their members' correspondent and payment systems that would have occurred if they had been forced to immediately withdraw from U.S. Central services. We believe many credit unions have lingering questions regarding the circumstances of the PIC II issuance and regulatory waiver. Therefore, an investigation and disclosure of the causative factors will be necessary to fully restore the credibility and reputation of both the corporate network and its regulatory bodies.

Again, thank you for providing us with the opportunity to respond to the proposed regulation.

Sincerely,

David A. Savoie

David A. Savoie, CPA, CFE
President/CEO